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Mr Nick Ramsay AM
Chair of the Public Accounts Committee
National Assembly for Wales
Cardiff Bay
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Dear Nick

The Welsh Government's initial funding of the Circuit of Wales project

I have received a copy of the Welsh Government's response of 11 September 2017 to your letter of 12 July seeking written evidence from them, following the Committee's oral evidence session with the Deputy Permanent Secretary on 26 June.

I have a number of observations on the content of the Welsh Government's response, which I should like to draw to your attention in order to assist the Committee's consideration and preparation of its own report.

Where my comments relate primarily to the Circuit of Wales project issues that were the subject of my published audit report, these are set out in the Annex to this letter. However, I also have some specific comments on those aspects of the Welsh Government's response which relate to their handling of matters both before and after the publication of my audit report on 27 April 2017, and I have set these out below.

In **Question 25**, the Committee asked the Welsh Government whether officials had informally informed the Minister about my Report publication date. In the enclosure to my letter to Adam Price AM dated 8 May 2017 (which I have previously shared with the Committee), I set out the chronology of key dates leading to publication of my Report on 27 April. I find it very surprising that officials:

- did not alert the Minister about my Report's publication date until 24 April, even though my Study Director had informed the Deputy Permanent Secretary in writing about my publication intentions on 17 March; and
- did not take sufficient steps to ensure the factual accuracy of the Written Statement that was issued by the Minister on 27 April.

Question 27 asked the Welsh Government about lessons learned and remedial actions. I am naturally pleased that the Welsh Government has accepted in full all of my Report's recommendations and has already begun to take action on these.

Question 26 specifically asked the Welsh Government to elaborate on its previous assertion of factual inaccuracies within my Report. I share the Committee's concerns in

this matter and I am particularly concerned that in its written response the Welsh Government has continued to imply that such shortcomings exist without actually providing any evidenced examples, despite the Committee's direct request that it should do so.

I should therefore like to assure the Committee that:

- with the exception of one minor error (to which I have previously drawn the Committee's attention) in relation to the economic efficiency test being a UK test and not specifically a Welsh test [see Report, paragraph 2.8], I remain satisfied that my Report is factually correct; and
- there is nothing contained in any of the Welsh Government's evidence given in response to the Committee's oral and written questions that would cause me to modify my Report's conclusions.

The Committee will be aware that I am currently undertaking a review of Welsh Government support for business within my programme of national value for money studies. As part of that review, I intend to examine how the Welsh Government has improved its procedures and working practices in light of my previous recommendations and those of the Committee.

I hope that these comments and observations are of assistance to the Committee.

Yours sincerely



HUW VAUGHAN THOMAS
AUDITOR GENERAL FOR WALES

Enclosed:

Annex - Circuit of Wales Project: the Auditor General's observations on the Welsh Government's written evidence to the Committee

Circuit of Wales Project: the Auditor General's observations on the Welsh Government's written evidence to the Committee

Overall value for money

1. In response to **Question 1**, the Deputy Permanent Secretary has restated his belief that the Welsh Government achieved value for money from the £9.3 million of initial support it provided to the Circuit of Wales (CoW) project, notwithstanding its decision to refuse further publicly funded support. However, in response to **Question 4**, the Welsh Government acknowledges that the nearly £300,000 of public funds provided for the Heads of the Valleys Development Company (HoVDC) to acquire FTR Moto Limited [a Buckinghamshire-based specialist motorcycle engineering company, now in administration] did not represent value for money.
2. The Committee questioned the extent of Welsh Government scrutiny and challenge of payments made to HoVDC's suppliers on the basis of monthly retainers and requested evidence of value for money (**Question 2**). The Welsh Government response states: *'All of the invoices stated the services supplied to HoVDC and the associated costs...'* However, this statement is not borne out by my auditors' examination of information held within the Welsh Government's own files, which contain invoices for monthly fees without any detail of actual services provided or costs incurred [see also my Report, paragraphs 3.22 – 3.25].
3. The Welsh Government goes on to list services which it says HoVDC has told them were covered by the monthly retainer of £42,000 paid to Aventa [a company contracted by HoVDC to raise private investment funds for the CoW project, wholly owned by HoVDC Chief Executive Michael Carrick]. It does not say when HoVDC provided this information, which the Welsh Government did not make available to my auditors during their review. However, Mr Carrick did provide information to my auditors about Aventa's fees and services though this does not match the Welsh Government's list.
4. In my report, I concluded that the Welsh Government had permitted payments without sufficient evidence that the services provided to the CoW project represented good value for public money [see paragraph 15]. The Welsh Government states that officials *'believed that the value of the retainers was appropriate'*, but has not provided the Committee with any contemporaneous evidence of what this belief was based upon that would lead me to alter my conclusion.

The acquisition of FTR

5. The Committee asked the Welsh Government for clarification and evidence relating to:
 - whether HoVDC's acquisition of FTR Moto Limited represented value for public money;

- the rationale for the Welsh Government's approval of grant funding for the acquisition;
 - whether the acquisition aligned with the grant scheme's purposes;
 - about the extent of specific scrutiny of the acquisition's inclusion within approved grant expenditure;
 - whether officials had drawn their Minister's attention to the FTR item; and
 - the quality of Welsh Government record-keeping.
6. I acknowledge that the Deputy Permanent Secretary has changed his view from that which he expressed at PAC in June; and that he now accepts that the FTR acquisition does not represent value for public money. However, in my view the Welsh Government's response does not adequately explain why HoVDC's acquisition of FTR was necessary for phase 1 of the Project, or provide sufficient justification for why the Welsh Government approved PDG funding for it. In essence, the Welsh Government approved £300,000 of grant funding intended for property development in Wales so that HoVDC could acquire a small engineering company in Buckinghamshire.
7. The Welsh Government's explanation to the Committee of why it did this hinges upon investor confidence in the initial circuit construction project being supported by FTR's relocation to a technology business park, in turn encouraging other motorsport companies to establish themselves there. In my Report, I highlighted:
- The lack of any contemporaneous Welsh Government documentation to support this (or indeed any) rationale for providing grant funding for the acquisition [paragraph 4.5].
 - A motor sport-related business park did not form part of the CoW project's first phase comprising fund-raising, obtaining planning consent and site acquisition, for which the grant was provided, nor was it part of the second phase of constructing the race circuit and associated facilities, for which HoVDC sought private investors [paragraphs 9, 1.7, 4.4; and exhibit 2].
9. The Welsh Government's explanation might therefore provide some degree of justification for relocation support to FTR at a future point, assuming completion and successful operation of the race circuit and then subsequent development of a business park, but this did not form any part of phase 1 of the CoW project.
10. The Welsh Government has suggested to the Committee that delaying FTR's acquisition would have weakened the business case for private investment and that its inclusion within phase 1 indicated *'interest and a level of commitment'* to the circuit and technology park. However, the business case submitted to the Welsh Government by HoVDC did not include FTR's acquisition [see Report paragraph 4.1] and the 'interest' and 'commitment' was from a company that HoVDC had itself already acquired before the Welsh Government awarded the grant [Report paragraph 4.2].

11. The Welsh Government has also asserted that the rationale for the FTR acquisition had been 'verbally questioned' by officials and has accepted that PDG support for the transaction should have been subject to greater scrutiny before approval was granted. However, I note that it has been unable to provide PAC with evidence of any actual scrutiny or challenge of the statements made to it by HoVDC, or indeed of its own decision-making in relation to FTR.
12. The Deputy Permanent Secretary has acknowledged in his response to **Question 8** that officials should have reviewed the FTR acquisition contract, but also that he is unable to confirm that this took place. In my Report [paragraph 4.3] I identified that the Welsh Government had not actually obtained a copy of the contract.
13. In my Report, I identified that the Welsh Government's submission to the Minister did not mention FTR [paragraph 4.2]. In its response to **Question 9**, the Welsh Government has stated that submissions to ministers for approval do not normally detail all eligible expenditure. The response to **Question 8** notes that improvements to its scrutiny processes should ensure that exceptional items will now be highlighted within a grant application, and that the Welsh Government expects that an item such as FTR would now be reported to the relevant minister. I believe it is important that the officials preparing such submissions should take responsibility for identifying any exceptional items, and not simply rely on the scrutiny process to highlight them
14. The Welsh Government's response to **Question 4** is unclear as to whether officials took the decision to approve PDG for the FTR acquisition before or after the Minister's decision to award the grant. It states '*The decision to provide funding was taken at an early stage*', but two paragraphs later appears to contradict this with '*...officials agreed during the negotiation of the award letter, that the purchase was a key component...*'
15. The Welsh Government's response to **Question 8** indicates that officials still enjoy considerable discretion when preparing award letters, following the minister's decision. There appears to be a risk that, in exercising this discretion, officials could potentially undermine the effectiveness of scrutiny prior to the minister's decision.
16. **Question 10** focused on documentation and record keeping, an issue that has concerned the Committee on several previous occasions. The Welsh Government's response, that in effect officials were too busy to maintain proper records, obviously has potentially wider and worrying implications for the Department's conduct of public business.

Further questions in response to oral evidence

17. In **Question 11**, the Committee asked about the Welsh Government's provision of loan guarantees. I will be considering the extent to which guarantees are requested, declined or provided as part of my wider review of business finance support.
18. **Question 12** sought clarification that arrangements to provide an appropriate separation of duties are operating as intended [see also my Report paragraphs 3.38 –

3.41]. I note that, on the basis that the official's Email, quoted by the Welsh Government in its response, constituted a recommendation rather than an instruction to make payment, the Deputy Permanent Secretary is content that an appropriate separation of duties was maintained.

19. **Question 13** concerned a returnable £100,000 deposit held in suspension, payable or repayable depending upon whether a conditional land sale transaction was completed. Whilst the sum was certainly 'eligible expenditure' under the terms of the grant, I concluded [Report, paragraphs 3.38 – 3.40] that, although paid by HoVDC into an escrow account, it should not have been claimable until actually paid over to the seller at completion. This would have avoided the situation whereby a claim for a repayable deposit is paid by the Welsh Government and then the deposit is returned, resulting in a net financial gain to the claimant. I am surprised that the Welsh Government is apparently content to continue to approve payment of claims for returnable deposits without first ensuring that if the transaction to which the deposit relates is not subsequently completed, then either:

- the deposit is returned directly to the Welsh Government and not to the claimant; or
- the amount claimed is repaid to the Welsh Government by the claimant.

20. **Question 19** asked why the Welsh Government had disputed the number of related companies or individuals who had received payments under the grant or loan guarantee arrangements stated in my Report [paragraphs 3.22 – 3.25], even though this had been fact checked with Michael Carrick by my study team and he had not challenged the information himself.

21. The Welsh Government's response states '*We would not necessarily consider directors or shareholders of related companies as having the ability to influence the company being funded in the normal course of business and so would not look at them, focusing only on those individuals with direct means to influence.*' This misses the essential point raised in my Report. This was not that the companies or individuals were necessarily able to influence HoVDC overall, but rather that they were related party suppliers and that therefore the Welsh Government should have taken appropriate steps to ensure value for money before approving payments to them.

22. The Welsh Government states '*Any [related] companies used as suppliers must provide their services on an arms-length basis and be able to demonstrate value for money.*' However, I note that the Welsh Government did not ensure that this was the case in relation to its funding support for the CoW project. Having reviewed the written response carefully, I remain concerned that the Welsh Government:

- Excludes first and then considers by exception. Good practice is to consider first and exclude afterwards;
- Would seemingly exclude from its consideration companies such as Kalergo Ltd, which received monthly retainer payments under the Welsh Government's

loan guarantee arrangement totalling nearly £97,000, against invoices that did not detail costs and services, whose sole officer and shareholder is also Aventa's Chief Finance Officer; and

- Was unaware of many of the relationships that I had identified during my audit fieldwork until being alerted to them by my study team.

23. **Question 20** related to the amount that would be 'at risk' if the CoW project did not proceed. In oral evidence to PAC the Additional Accounting Officer quoted a figure of £55 million at risk, including Welsh Government exposure of about £9.2 million. I note that the Welsh Government did not undertake detailed validation of the figure, which was provided to them by HoVDC, but also that it did not apparently feature in the submission provided to the Cabinet to inform its June 2017 decision on whether or not to provide further support to the Project.

24. **Question 23** asked about HM Treasury's accounting classification of CoW debt if the Project went ahead. The Welsh Government's response focuses on discussions about risk but does not address directly one key element of the Committee's question, which asked when the actual accounting problem was first identified.

Responses to Questions raised by the Committee Clerk in June 2017

25. In response to the Clerk's second question, the Welsh Government has stated that the minimum standards developed by the Welsh Government's Grants Centre of Excellence '*... would have been utilised in respect of the **recent** application from the Circuit of Wales*'. I note that the Welsh Government has not provided the Committee with any assurance that the Welsh Government applied these standards in relation to their **initial** funding for the CoW project, which was the subject of my Report.